

Message Text

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SUBJ: SPANISH ECONOMIC CONDITIONS IN THE TRANSITION PERIOD

1. SUMMARY: THE INTERPLAY OF POLITICAL AND ECONOMIC FACTORS DURING THE TRANSITION PERIOD WILL HAVE IMPORTANT CONSEQUENCES FOR THE STABILITY OF SPANISH SOCIETY IN THE COMING 12 MONTHS AND BEYOND. THE PRESENT ECONOMIC SITUATION IS ONLY FAIR TO POOR, WITH 17 PERCENT INFLATION, A LARGE CURENT ACCOUNT BALANCE OF PAYMENTS DEFICIT, RISING UNEMPLOYMENT, AND LITTLE REAL ECONOMIC GROWTH. ANY IMPROVEMENT IN THE NEXT 6-12 MONTHS IS LARGELY CONTINGENT ON ECONOMIC RECOVERY IN THE US AND W.EUROPE, THE ABSENCE OF WHICH WILL ENSURE THAT THE SPANISH ECONOMY REMAINS IN THE DOLDRUMS. IF THAT HAPPENS, ECONOMIC/SOCIAL ISSUES MAY ALSO BECOME MAJOR POLITICAL ISSUES. AT THE PRESENT TIME, HOWEVER, THE ECONOMIC SITUATION DOES NOT SEEM TO BE CAUSING ANY IMPORTANT POLITICAL REPERCUSSIONS AND, CONVERSELY, POLITICAL UNCERTAINTIES ARE STILL HAVING ONLY MARGINAL CONSEQUENCES ON THE ECONOMY. WHILE THE DEPARTURE OF FRANCO MAY BE FOLLOWED IN DUE COURSE BY DESTABILIZING LABOR DEMANDS FOR A STILL BETTER DISTRIBUTION OF INCOME, THE VAST IMPROVEMENT

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IN ECONOMIC WELL-BEING WHICH THE AVERAGE SPANIARD HAS

ACHIEVED OVER RECENT YEARS SHOULD PROVIDE ANY NEW REGIME A GRACE PERIOD OF PERHAPS 6 MONTHS IN WHICH TO CONCENTRATE ON THE PURELY POLITICAL WITHOUT HAVING TO BE PRIMARILY OCCUPIED WITH ECONOMIC CONDITIONS, IF DEPRESSED ECONOMIC CONDITIONS PREVAIL BEYOND THIS POINT, AND LABOR IS ASSERTIVE, THE ECONOMY COULD BECOME A DECIDEDLY MORE NEGATIVE FACTOR IN SPAIN'S POLITICAL FUTURE. END SUMMARY.

2. WITH SPAIN IN TRANSITION TO A MONARCHY UNDER JUAN CARLOS AFTER NEARLY 40 YEARS WITH FRANCO AT THE HELM, THE INFLUENCE OF ECONOMIC CONDITIONS ON POLITICAL EVOLUTION AND, CONVERSELY, THE IMPACT OF POLITICAL CONDITIONS ON THE ECONOMY COULD BE VERY IMPORTANT, DURING THE NEXT FEW MONTHS AND OVER THE LONGER RUN.

3. AFTER MORE THAN A DECADE OF RAPID GROWTH, THE SPANISH ECONOMY IS TEMPORARILY DEPRESSED DUE TO THE WORLD-WIDE RECESSION, AND THE OUTLOOK IS FOR LITTLE IF ANY IMPROVEMENT OVER THE NEXT 6 TO 12 MONTHS. THE PRESENT DEPRESSED SITUATION IS CHARACTERIZED BY AT LEAST 17 PERCENT INFLATION, PERSISTENT BALANCE OF PAYMENTS DIFFICULTIES, GRADUALLY INCREASING UNEMPLOYMENT, AND A LOW LEVEL OF REAL ECONOMIC GROWTH. ALTHOUGH FOREIGN EXCHANGE RESERVES ARE STILL OVER \$6 BILLION, DUE IN PART TO UNEXPECTEDLY HIGH EARNINGS FROM TOURISM, THE TRADE DEFICIT CONTINUES TO WIDEN, AND SPAIN HAS RESORTED TO SUBSTANTIAL FOREIGN BORROWING TO COMPENSATE FOR A CURRENT ACCOUNT DEFICIT WHICH SHOULD BE SOMEWHERE BETWEEN \$2.5 AND \$3 BILLION THIS YEAR. SPAIN'S BALANCE OF PAYMENTS IS EXPECTED TO IMPROVE SLIGHTLY IN 1976, BUT HIGH OIL PRICES, WHICH HELPED PRECIPITATE THE PRESENT DIFFICULTIES, WILL CONTINUE TO BE A MAJOR PROBLEM SINCE SPAIN IS SO DEPENDENT ON IMPORTED FUEL.

4. DURING 1974, THE PROSPECT OF INCREASED UNEMPLOYMENT WAS THE MAJOR STATED CONCERN, AND GOVERNMENT POLICY WAS TO STIMULATE GROWTH AT THE EXPENSE OF SOME INCREASE IN PRICES AND LOSS OF RESERVES. CONTINUING INFLATION AND BALANCE OF PAYMENTS DIFFICULTIES THROUGHOUT THIS YEAR, HOWEVER, HAVE REVERSED THESE PRIORITIES AND HAVE PLACED RESTRAINTS ON THE GOVERNMENT'S WILLINGNESS AND ABILITY TO STIMULATE RECOVERY

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OF ECONOMIC ACTIVITY. THE GROWTH RATE HAS DECLINED SHARPLY SINCE MID-1974, AND, AT PROBABLY NO MORE THAN 1 PERCENT IN REAL TERMS, IS IN SHARP CONTRAST WITH RATES OF NEARLY 8 PERCENT FOR 1973 AND 5 PERCENT FOR 1974. AS A RESULT, UNEMPLOYMENT HAS RISEN TO AN UNOFFICIALLY ESTIMATED 4.5 TO 5 PERCENT OF THE WORK FORCE, COMPARED WITH ABOUT HALF THAT FIGURE A YEAR AGO. THE GOS BUDGET FOR 1976 IS

19.6 PERCENT OVER 1975, BUT GIVEN THE PRESENT LEVEL OF INFLATION THIS WILL PROVIDE LITTLE REAL STIMULUS TO THE ECONOMY. MONETARY POLICY IS MILDLY RESTRICTIVE, AIMED AT SLOWING INFLATION BUT AVOIDING A SERIOUS CREDIT SQUEEZE.

5. THE SPANISH ECONOMIC OUTLOOK DEPENDS IN LARGE MEASURE ON WHAT HAPPENS IN THE US AND MAJOR WESTERN EUROPEAN COUNTRIES. SPAIN NEEDS RECOVERY ABROAD TO SPUR RECOVERY HERE THROUGH RENEWED DEMAND FOR SPANISH EXPORTS, INCREASED TOURISM AND WORKERS' REMITTANCES, AND THE RESUMPTION OF A HIGH LEVEL OF FOREIGN INVESTMENT. SPAIN'S DIFFICULTY IS AS MUCH ONE OF TIMING AS ANYTHING ELSE; BEING ABLE TO RIDE OUT THE PRESENT SLUMP WITHOUT INCURRING ECONOMICALLY INSPIRED POLITICAL DISRUPTIONS, WHILE HOPING FOR RECOVERY ABROAD. WHILE POLITICAL UNCERTAINTY DURING THE PAST YEAR HAS PROBABLY CONTRIBUTED TO INVESTOR AND CAUTION, AND MAY CONTINUE TO DO SO, OBJECTIVE ECONOMIC CONSIDERATIONS HAVE BEEN THE MAIN REASONS FOR THE SLACK IN ACTIVITY.

6. CONVESELY, THE DEPRESSED ECONOMIC SITUATION DOES NOT APPEAR TO BE HAVING A NOTICEABLE EFFECT ON THE POLITICAL CLIMATE. NEITHER THE CIVIL DISQUIET NOR POLITICAL MANEUVERING OF RECENT MONTHS HAS BEEN MOTIVATED BY ECONOMIC CONSIDERATIONS, SPAIN IS CLEARLY UNLUCKY THAT IT IS TOUCHING OR APPROACHING THE BOTTOM OF AN ECONOMIC CYCLE AT SUCH A CRUCIAL TIME POLITICALLY, AND THAT NOTHING EXPECTED IN THE WAY OF ECONOMIC PERFORMANCE OVER THE NEXT SEVERAL MONTHS WILL CONTRIBUTE TO A SMOOTH TRANSITION, ON THE OTHER HAND, JUAN CARLOS IS NOT BY ANY MEANS INHERTING AN ECONOMIC

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MORASS. THE IMPRESSIVE INDUSTRIALIZATION, THE DEVELOPMENT OF A LARGE AND FAIRLY AFFLUENT MIDDLE CLASS, AND THE GENERAL WELL-BEING OF THE SPANISH PEOPLE AS A RESULT OF 15 YEARS OF RAPID ECONOMIC GROWTH SHOULD PROVE ON BALANCE A STABILIZING FACTOR IN THIS PERIOD OF POLITICAL TRANSITION.

7. LOOKING AHEAD SIX MONTHS TO A YEAR, THERE IS THE POSSIBILITY OF THE ECONOMY BECOMING A NEGATIVE FACTOR AND OF THE EMERGENCE OF SERIOUS PROBLEMS OF A POLITICO-ECONOMIC NATURE. HIGH WAGE SETTLEMENTS EXPECTED OVER THE NEXT FEW MONTHS WILL FURTHER COMPLICATE EFFORTS TO COUNTER INFLATION, BUT IT WILL BE POLITICALLY DIFFICULT TO RESIST THEM. IF ECONOMIC RECOVERY DOES NOT BEGIN DURING 1976 IN

EUROPE AND IN SPAIN, THE UNEMPLOYMENT PROBLEM COULD BE EXACERBATED BY THE NEED OF SPANISH FIRMS TO CUT THEIR WORK FORCES FURTHER, AN INCRAASING RETURN OF MIGRANT WORKERS AS UNEMPLOYMENT BENEFITS RUN-OUT IN NORTHERN EUROPE, AND REDUCED OPPORTUNITY FOR NEW JOBS ABROAD. WHILE THE UNEMPLOYMENT RATE THIS YEAR REPORTEDLY HAS HAD A TEMPORIZING EFFECT ON LABOR MILITANCY, IN A SCENARIO OF CONTINUING INFLATION, COUPLED WITH SUBSTANTIALLY INCREASED UNEMPLOYMENT, PROBLEMS SUCH AS REGIONAL ECONOMIC DISPARITIES, INEQUITABLE INCOME DISTRIBUTION, SOCIAL IMMOBILITY, AND ALLEGED ECONOMIC MISMANAGEMENT COULD BECOME RALLYING CRIES FOR MORE RADICAL SOLUTIONS.

8. IF, HOWEVER, RECOVERY OF THE WORLD ECONOMY IS WELL UNDERWAY BY MID-1976, AND THE POLITICAL SUCCESSION IS RELATIVELY SMOOTH, THERE ARE NO REASONS WHY THE SPANISH ECONOMY SHOULD NOT RETURN TO HIGH LEVELS OF ECONOMIC ACTIVITY AND GROWTH WHICH WILL CONTRIBUTE TO POLITICAL FLEXIBILITY AND MODERATION. ENOUGH GOOD WILL AND ECONOMIC IMPROVEMENT HAVE BEEN CREATED SINCE 1959 TO PROVIDE JUAN CARLOS RATHER SIZEABLE "RESERVES" TO DRAW ON AND WITH A LITTLE LUCK, IT NEED NOT BE THE ECONOMY THAT CAUSES THE BIGGEST POLITICAL PROBLEMS FOR POST-FRANCO SPAIN FOR THE FORESEEABLE FUTURE.
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